

USAID INSIGHT

THREE PILLARS TO SUPPORT NEW PENSION REFORM IN UKRAINE

Let us take heed and not permit our age to leave more wrinkles on our soul than on our face," said Michel de Montaigne, a Renaissance philosopher.

Just a few years ago, the post-Soviet countries began to rectify neglect of their elderly and improve gradually the living standards of senior citizens. Russia, Kazakhstan, Moldova, Poland, Bulgaria and other CIS and EU countries have acknowledged the need to ensure a basic existence for their citizens in old age. And now the time for pension revolution has come to Ukraine.

A solidarity, "pay-as-you-go," (PAYG) Soviet-type pension system, where individuals receive the same compensation in retirement irrespective of individual input, has remained in place even after Ukraine gained independence. It has satisfied neither pensioners and employees nor employers. The high levels of required contributions to the Pension Fund have led many employers to compensate workers under the table;

moreover, the pension system did not let people affect the amount of their future pensions.

Ukraine's pension system is undergoing a reformation. Incorporating international best practices, the Ukrainian Government is building a new pension system that seeks to ensure long-term financial sustainability and adequate pension benefits for Ukraine's retired population.

The main objective of the new pension system is to create new opportunities for people to influence the amount of their future pension benefits, providing adequate, regular and dependable income to senior citizens, ensuring proper replacement of individual's earnings with their retirement income as well as poverty reduction in old age.

The new pension system is supported by "three pillars." The first pillar, Pillar I, is an solidarity system; Pillar II is a mandatory accumulation pension system; Pillar III is a voluntary system of private pensions. Improved Pillar I and Pillar III systems have

been functioning in Ukraine since January 1, 2004 (Non-State Pension Funds (NPFs) have been collecting contributions since early 2005). Pillar II, or the mandatory accumulation pension system, is planned to be launched in January 1, 2009.

One of the major advantages of the new pension system is that it takes into account the interests of all social groups. Each of the three pillars is targeted at a particular social group: Pillar I is for everybody, Pillar II is mostly for young people, and Pillar III is for the well-to-do, who, want to save extra funds for their old age. There is a so called Pillar 0 in Ukraine, which provides for social assistance paid by the State budget to lower income citizens and to the disabled that have not accrued pension rights.

The development of the new pension system depends on certain economic and political prerequisites. The Pension Fund deficit resulting from increased pensions

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UKRAINE DEVELOPS NON-STATE PENSION FUNDS

Seeking to become a member of the world community, Ukraine is implementing the successful practices of developed economies. A good example is passage by the Verkhovna Rada of the Law "On Non-State Pension Provision" in 2004. With its passage, the country now has a legal framework for the operations of Non-State Pension Funds (NPFs), and Ukraine's citizens now have an opportunity to influence the amount of their pension benefits that will be paid to them in addition to their solidarity pensions once they retire.

The main goal of a NPF is to accumulate and increase the voluntary pension contributions of its participants. Every Ukrainian citizen has the right to see **NPFs**, page 4



A cartoon, in which Pinocchio encourages Geppetto to invest into a NPF instead of Elita and MMM investment scams.

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PENSION HOTLINE HELPS UKRAINIANS

If you are an average Ukrainian you have probably read or heard something about pension reform in Ukraine. And you are sure to know something about pensions: they can be state or non-state, special or professional. But also like many other Ukrainians when you are trying to find answers on the questions about your personal pension, you get lost in the amount of information.

To help Ukrainians better understand how the new system works and what benefits it can bring, the Ministry of Labor and Social Policy of Ukraine, the Pension Fund of Ukraine and the State Commission for Regulation of Financial Services Markets in Ukraine established the Pension Hotline. The Hotline which is run with USAID support has operators that are certified lawyers with substantial experience in the social



"Ask an Expert" on www.pension.kiev.ua

assistance area. Most of them began working back in October 2003 when the Hotline was launched. As of today, they have answered more than 220,000 calls from all over Ukraine. In addition they also answer questions in writing on the "Ask an Expert" Forum of the USAID-supported web-site.



Halyna Sidorenko (left) and Nadia Tkach (right) answering Hotline calls. (Photo: Courtesy of Capital Markets Project)

The day we visited the Hotline it was Nadia's and Halyna's turn to answer people's calls. We met them in their office in the Head-quarters of the Ministry of Labor and Social Policy. Their phones were ringing incessantly, and we had to wait patiently while they provided consultation to people. We had a moment to look around the comfortable room: two well-equipped working places, computers and papers on the shelves as sources of important information on pension reform issues. When the phones went silent for a few minutes, we had a chance to speak with them.

Q.: Your phones keep ringing constantly. How many calls do you manage to answer during the day?

N.: Approximately 200 calls per day, plus we also answer up to 40 questions a week on "Ask an Expert" Forum web-site.

Q.: How do people learn about the Hotline?

How can you describe people who call the Hotline?

H.: Usually they learn about us from newspapers, such as *Pension Courier*, *Pension*, *Fakty*, as well as from the USAID Capital Markets Project's pension website. Lately we've received calls from people who had learned about our Hotline from numerous TV interviews with specialists from the Ministry of Labor and Social Policy. I am pleased that not only current pensioners call, but also young people who are thinking about their future pensions. We also receive calls from the Pension Fund of Ukraine regional offices, accountants and Human Resources Managers of Ukrainian enterprises on how to calculate covered service periods of their employees.

Q.: Have you any interesting stories about your work?

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ARE YOU READY TO BECOME A PENSIONER?

1. **How often do you think about your future retirement?**
 - a. Rather frequently. (10 points)
 - b. Sometimes. (5 points)
 - c. Never. (2 points)
2. **Are you a female or male between the ages of 25-50 years old?**
 - a. No. (5 points)
 - b. Yes. (10 points)
3. **Are you satisfied with the average pension amount paid to pensioners today?**
 - a. No, I am not. (10 points)
 - b. It could be larger, but I can't influence the situation. (5 points)
 - c. I am completely satisfied. (2 points)
4. **Would you like to be a well-to-do pensioner?**
 - a. Yes, I would. (10 points)
 - b. I do not know. (5 points)
 - c. I am used to getting by. (2 points)
5. **Are you ready to save 20-100 hrv. a month for your future pension?**
 - a. Yes. (10 points)
 - b. No. (5 points)
6. **Would you like your pension savings to increase continuously?**
 - a. Yes. (10 points)
 - b. No. (5 points)
7. **Would you like to receive private pension benefits in addition to your solidarity pension?**
 - a. Yes. (10 points)
 - b. No. (5 points)
8. **Do you know that pension reform is being implemented in Ukraine?**
 - a. Of course I know. (10 points)
 - b. I have heard something. (5 points)
 - c. I am not interested. (2 points)
9. **Do you know anything about Non-State Pension Fund (NPF)?**
 - a. I am well informed. (10 points)
 - b. I read something. (5 points)
 - c. I don't know anything about them. (2 points)
10. **Are you ready to pay contributions to a NPF?**
 - a. I am a NPF participant. (10 points)
 - b. I am going to become a NPF participant. (5 points)
 - c. I am not interested. (2 points)

RESULTS:

76 to 100 points - You have a real chance to live well, travel abroad and enjoy your grandchildren when you retire.

51 to 75 points - You run the risks of having only a solidarity pension to fall back on once you retire, but you have a chance to rectify the situation.

33 to 50 points - Unfortunately you will have to scrape by in your pension years or start now to understand your options.

Public-Private Partnership Helps Senior Citizens



Milaniya Achkasova thanks a volunteer for much-needed food she received during the holidays last year. (Photo: Sarah Jewett)

Milaniya Achkasova celebrated her 83rd birthday last January. After working for 40 years at a local factory in the city of Kharkiv, she has been retired for about 15 years. Her husband passed away in 1996 and since the couple had no children, Mrs. Achkasova has lived alone

and Philip Morris to organize the project. DOM distributed 8,000 food packages to Kharkiv citizens in need, many of them single, low-income pensioners and people with disabilities. They worked with the city and regional social services departments, local NGOs and local businesses to deliver

since then. While she mentions this with sadness, she keeps a positive outlook. "All I need is my health!" she said.

This is the second year that Mrs. Achkasova has received a food package containing essential items like canned meat, pasta, buckwheat, oil, tea, sugar and biscuits. The packages were delivered by the local NGO Democratic Union of Youth (DOM) and paid for by Philip Morris Ukraine. A year ago, the Eurasia Foundation worked with DOM

the packages, setting a strong example for public-private partnerships for other businesses to follow. The Eurasia Foundation recently published a case study based on the experience, which is now helping other NGOs and businesses to do just that. And DOM and Philip Morris Ukraine have continued the project this past year on their own, a testament to the strength and sustainability of the model.

"I'm very grateful for the food," said Mrs. Achkasova when she received her package this January. "It is extremely helpful, especially for someone like me who lives alone."

The project is part of the Eurasia Foundation's *Encouraging Corporate Citizenship* program, launched in four regions of Ukraine in 2004-2005, and made possible by support from USAID. The program encourages local businesses to support social projects by working with civic society organizations. Encouraging local money to support local causes will help charities be less dependent on the government or foreign donors. And as a growing number of businesses follow this example, civic society organizations will be able to help more people like Milaniya Achkasova. This year, DOM added a personal touch which prompted a smile from Mrs. Achkasova: as a special birthday surprise, they also presented her with a box of chocolates.

HOTLINE HELPS WOMAN TO GET PENSION INCREASE

Nadia, a 54-year-old woman, from Nosivka, a small town in Chernigiv oblast, retired a year ago due to health problems. All her life she worked very hard, first as a civil servant in the USSR State Bank in Nosivka for almost 20 years and after the collapse of the Soviet Union when the bank was privatized and transformed into the Joint-Stock Commercial Bank "Ukraine," she continued her work there as a Chief of the Credit Department. After Ukraine Bank's bankruptcy in 2000 Nadia joined the Nosivka Rayon State Administration in the Financial and Commercial Department.

Her life has not been easy. Her husband, a policeman, was frequently away from home handling criminal accidents as well as working the night shift, and she had to raise her two sons practically alone. Usually the strains and sorrows of life tell on your health. This happened to Nadia when in the summer of 2005 she was diagnosed with breast cancer. An immediate operation followed, after which she was qualified as Group II invalid with an entitlement to disability pension as a civil servant. Nadia was pressed for money. After the operation she was put on medicine for 5 years, which along with drugs she takes to control diabetes costs her a



Nadia with her grandson Nikita on his first day at school. (Photo: Courtesy of Capital Markets Project)

fortune and left little money for anything else. Nadia was in despair. Fortunately, in January 2006 in compliance with the Cabinet of Ministers Resolution, wages to civil servants were increased. (Note: Pensions to civil servants are recalculated each time there is an increase in civil service wages). Therefore, Nadia's ex-employer, i.e. the Nosivka State Administration, updated her wage record, which the Pension Fund of

Ukraine uses to calculate pensions. Nadia also learned from her ex-colleagues that they had been granted bonuses that month, which means that the Administration should have included the information about bonuses into her record as well. But they forgot to do this. Without this information the pension increase would be just de minimus. She decided to apply to the Nosivka State Administration to amend her record, but was refused on the grounds that there was no specialist hired to replace Nadia in her position.

Unable to prove her case, but unwilling to give up, Nadia decided to look for professional assistance. She called the Pension Hotline. Based on advice from the Hotline operators, Nadia filed an application with the Nosivka Rayon State Administration referring them to the new Cabinet of Ministers

Resolution that provides for pension increases to civil servants based on the average amount of all bonuses that were paid to specialists holding similar positions within a state institution.

Life has improved for Nadia since that time. She received a 30% increase in her pension and now can afford not only medicine for herself, but small treats for her little grandson Nikita, who started school this year.

Non-State Pension Funds Provide a More Comfortable Retirement

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select the most efficiently operating private fund. Having opened an account with a fund, one has the right to define the rate and schedule of contributions s/he pays into the account. This allows the participant to decide the amount of the additional pension that will be paid after s/he reaches retirement age.

USAID is providing active assistance for the formation of Non-State Pension Funds in Ukraine. In developing stage of the regulatory and legal framework for the non-state pension provision, USAID assisted Ukrainian specialists by conducting working group meetings and workshops. International experts provided active consultations to specialists from the Ministry of Labor and Social Policy, the Securities and Stock Market State Commission, the Pension Fund of Ukraine and State Commission for Regulation of Financial Services Markets on the best international practices on private pension provision and implementation of such practices in Ukraine.

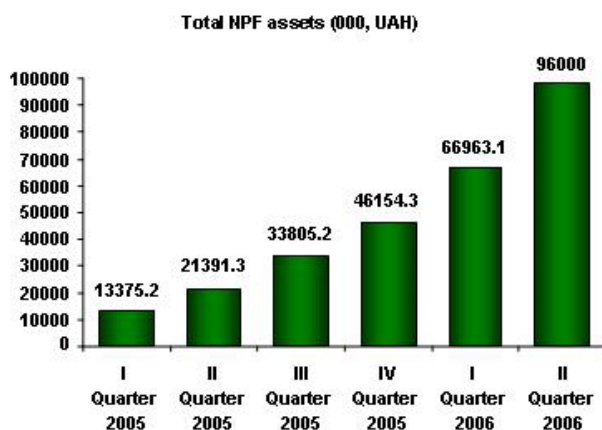
With USAID support, the State regulators implemented training programs for specialists and active public awareness campaigns on the effective development of NPFs' policies and on NPFs' operational principles. In addition, USAID is collaborating successfully with non-government organizations and bringing together specialists who will be instrumental in the future development of Non-State Pension Funds. As

with any other new development effort, the NPF meets with certain challenges. According to a recent sociological survey, practically all respondents welcomed the new opportunity to receive additional pension; however, people were not sure whether the new entities could be trusted with their money.

An educational program will be needed to gain Ukrainian citizens trust and to educate them on how to make use of these new opportunities. It is necessary to educate Ukrainian people on the basic concepts of NPF activity; explain where NPFs' assets will be invested and how investment can increase the amount of future pension.

Nevertheless NPFs development trend is quite optimistic. According to the latest data, more than 50 NPFs have been established within 2.5 years since the passage of the Law in 2004, and

NPFs have accumulated approximately UAH 100 million to date. Especially striking was the period between March 2005 and March 2006, with NPFs assets increasing by 500%. USAID's Capital Market Project aims to continue efforts to effectively support NPFs development in Ukraine. CMP will continue to provide experts-and-consultancy and technical assistance to the State regulators and NGOs with regard to education of the population, and the development and implementation of training programs for specialists.



PENSION REFORM

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for existing pensioners and differences in pension rates are the main factors that have negatively affect the financial sustainability of the solidarity system. However, the Draft Law of Ukraine "On the State Budget of Ukraine for 2007," requires the Pension Fund to be balanced.

Improvements in calculating pension benefits from the solidarity system has produced a significant increase in pensions for citizens. In particular, at the moment of implementation of the 2003 Law on the Pension reform in Ukraine, the average pension from Pillar I system was UAH 92.47 or 34.5% of the minimum subsistence level for individuals incapable-of-work. Within 2.5 years of the implementation of the law, it amounted to UAH 441.81 (as of July 1, 2006) or 123% of the minimum subsistence level set for individuals incapable-of-work.

Pension payments from the proposed Pillar II for people reaching retirement age will consist of the contributions to the Accumulation Fund plus investment return on these funds less operational expenses for services provided. The current retirement age in Ukraine is 60 years for men and 55 for women, this is not only inequitable, but low compared with other European countries. To avoid disproportionate payments in pension benefits from Pillar II for men and women it is proposed to equalize their retirement age.

The amount of pension contributions to the Non-State Pension Funds (NPFs) grew to UAH 96 million in the second quarter of 2006, compared with UAH 93,000 in 2004. As compared with the first quarter of 2005 the number of NPFs' participants has increased threefold and as of June 30, 2006, it totaled over 113,000 people.

The Ukrainian pension scheme's objective is to promote higher future pensions and reduce poverty in old age. Pension reform will also create new jobs and improve the real sector of the economy.

EXPERTS ANSWER QUESTIONS ON PENSION REFORM

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G.: In addition to providing advice to people on pension reform issues, sometimes we are just a "good ear" for our callers. In connection with hearing about problems of pensioners from remote villages, we often hear about their chickens not laying eggs and cows not milking.

Q.: What do you enjoy about your work?

N.: We help people to resolve their problems with pensions. For example, when people call in connection with a delay in their pension benefits payment, we transfer the information about the delay to the Ministry of Labor, which coordinates with the Pension Fund of Ukraine. This helps to correct the situation immediately.

The solution to the problem is often an easy process.

Q.: What is your contribution to the pension reform of Ukraine?

N.: I think that our work is an effective outreach to citizens on all types of pension reform issues. We also help people understand their pension rights and obligations, which contribute to an increase in public awareness about the new three-pillar pension system and improves pension reform perceptions in Ukraine.

To find more information on pensions, ask an expert on USAID-supported web-site www.pension.kiev.ua or call free Hotline 8-800-500-39-20.



The United States Agency for International Development's (USAID) principal mission in Ukraine is to help the country to complete the transition to a broad-based democracy with a market-oriented economy. USAID assistance focuses on the following areas: **Economic Growth, Democracy and Governance, Health and Social Sector.** Since 1992, the USAID has provided \$1.6 billion worth of technical and humanitarian assistance to Ukraine to further the processes of democratic development, economic restructuring and social sector reform in the region. To obtain additional information about USAID programs in Ukraine please visit the USAID web-site at: <http://ukraine.usaid.gov> or e-mail omyrtsalo@usaid.gov